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S E C R E T SECTION 01 OF 03 PRAGUE 000117

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TAGS: [KCOR](#) [PGOV](#) [EINV](#) [EZ](#) [AU](#)  
SUBJECT: PANDURA'S BOX: CORRUPTION SCANDAL LIFTS THE LID ON  
CZECH DEFENSE PROCUREMENT

REF: A. PRAGUE 91  
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Classified By: Charge d'Affaires Mary Thompson-Jones for reasons 1.4 (b)  
) and (d)

[1](#)1. (C) Summary: Widespread Czech press reporting of alleged corruption by Czech politicians involved in a billion-dollar contract between General Dynamics' Austrian subsidiary Steyr and the Czech MoD for Pandur armored personnel carriers (APCs) is shaking the political scene. One newspaper's series of front-page stories about the contract and its course from 2003-2009 has now expanded to coverage by most media. With Social Democrats (center-left CSSD) and Civic Democrats (center-right ODS) implicated in the scandal and elections scheduled for May 2010, both major parties are trading accusations while trying to manage the fallout. Party leaders Jiri Paroubek (CSSD) and Mirek Topolanek (ODS) have called for a swift investigation and accused their opponents of the greater responsibility in the affair. Prime Minister Fischer pledged to carefully look into any "dirty dealings", and the police and state prosecutor's office have started an investigation. The main focus of the investigation is on the role of Steyr, its lobbyists, and Czech officials; there have been no accusations of malfeasance by General Dynamics. While the details are still unfolding, the episode highlights the susceptibility of Czech government procurement procedures to corruption due to a lack of transparency. End Summary.

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Background of the Contract  
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[1](#)2. (SBU) A CSSD Government Approves the Concept: In late 2003, a center-left CSSD-led government approved a plan to replace Soviet-era vehicles with 240 new APCs. In 2004, PricewaterhouseCoopers (PwC) was hired to organize a tender for the contract, a signal that the MoD was seeking greater assurance of transparency (reftel F). A tender for 199 APCs was let in 2005 under the new CSSD-led government of Prime Minister Stanislav Gross. General Dynamic's Austrian subsidiary, Steyr, entered the APC competition, while its other subsidiary, Swiss firm Mowag, stayed out, allowing General Dynamics and the USG to advocate for Steyr (reftel E).

[1](#)3. (U) Another CSSD Government Makes the Deal: Early in 2006, the government of yet another CSSD Prime Minister, Jiri Paroubek, selected Steyr as the winner of the contract for 23.6 billion crowns (USD 1B in early 2006). In June 2006, days after national elections, ODS announced it would cancel the tender once it formed the new government. Just before leaving office, then-Minister of Defense Karel Kuehnl (Freedom Union party) drew criticism from ODS for signing the

contract with Steyr for 199 APCs, with an option for 35 more.

¶4. (U) ODS Cancels the Deal and Remakes It: Through the course of 2007, however, the Ministry of Defense under the ODS-led government of PM Mirek Topolanek disputed the quality and timeliness of Steyr's Pandur deliveries. The government first eliminated the 35-vehicle "option" in May, and then unilaterally canceled the entire contract in December of 2007. General Dynamics lawyers responded by preparing to take the case to international arbitration. Intense negotiation (including USG advocacy for Steyr) followed into early 2008, and the Topolanek government agreed in April 2008 to purchase 107 Pandurs, subject to successful field testing. Finally, in March, 2009, shortly before the fall of the Topolanek government, then-Deputy Minister of Defense Martin Bartak (ODS) signed a revised contract with Steyr for 107 Pandurs at a cost of 14.4 billion crowns (USD 692M at March 2009 rates). The Czech Army received the first 17 Pandurs in September of 2009.

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The Current Scandal  
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¶5. (U) For most of the week of February 14, leading daily Mlada Fronta Dnes's (MFD) front pages and lead inside coverage have alleged a major bribery scandal in which six percent of Steyr's Pandur contract was supposedly parceled out as payoffs to CSSD and ODS. Those implicated include:

- Stanislav Gross (no longer in politics), whose government

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let the tender

- Karel Kuehnl (now Czech Ambassador in Croatia), who signed the 2006 contract with Steyr  
- Martin Bartak (current ODS Minister of Defense), who signed the renegotiated 2009 contract with Steyr as Deputy MoD  
- Jiri Paroubek (CSSD party chairman, and front runner for PM in the next government), whose government approved the 2006 deal with Steyr  
- Lubomir Zaoralek (CSSD shadow FM, and front runner to head the MFA for Paroubek), who was allegedly lobbied by Steyr in 2003

Now all media outlets have begun to run major stories about the affair. The primary focus is on Steyr, though at least one recent story speculates that General Dynamics' full ownership of Steyr could lead to FBI involvement in an investigation. MFD's reporting relies on conversations with two Austrian businessmen, Wolfgang Habitzl and Herwig Jedlaucnik, both former employees of Steyr and associated with the Pandur sale. They were recorded by hidden camera while MFD's reporter posed as a consultant seeking information about how to influence Czech politicians. (Note: Habitzl and Jedlaucnik have now retracted the information they provided to the MFD reporter about the purchase of Pandur vehicles, stating to the Austrian Press Agency, "It was a bad joke." End Note.)

¶6. (U) MFD also published two pages of a confidential 2002 agreement between Hans Malzacher, then CEO of Steyr, and Czech consultant Jan Vlcek. According to the agreement, Vlcek was engaged by Steyr (before the company's acquisition by General Dynamics in 2003) to arrange meetings with Czech officials to advance Steyr's Pandur marketing efforts. Vlcek claims to have withdrawn from the arrangement when he realized that bribery was involved. Habitzl and Jedlaucnik allege that, after Vlcek's departure, the payoffs were funneled through PAMCO, a Czech consulting firm owned by entrepreneur Pavel Musela, a friend of former PM Stanislav Gross.

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Political Reactions  
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¶7. (SBU) Because the Pandur contract was launched by CSSD-led governments in 2003-2006, then canceled and renegotiated by an ODS-led government in 2007-2009, both parties are vulnerable to accusations. Both have firmly denied wrongdoing while trying to shift blame to the other side. Concern about May election fallout was evident in Jiri Paroubek's initial reaction: "We expect...a prompt investigation with a preliminary report before the elections in May." Before meeting with Prime Minister Fischer about the case, Paroubek declared in a press release partially entitled, "Corruption is the cancer of this society," that the investigation should "let the chips fall where they may."

¶8. (U) CSSD is seeking bribery charges against Habitzl and Jedlaucnik in case their story is true, and a charge of slander against unknown perpetrators in case the affair is a politically-motivated ruse, or an attempt to exact commercial revenge. Regarding the latter scenarios, Paroubek claims the likely suspects are Miroslav Kalousek (currently a member of the newly-formed TOP09 party), arms trader Omnipol's head Richard Hava (whose firm would have acted as middleman for Finland's Patria, a loser in the APC tender), and lobbyist and one-time ODS media advisor Michal Kuzmiak.

¶9. (U) ODS's most vocal response has come from Defense Minister Bartak. Reacting to charges that the price of the renegotiated contract was suspiciously higher than the original cost -- and considerably more than the per-vehicle cost of Portugal's Pandur contract -- Bartak's MoD has issued detailed press releases. These statements argue that differences in the number of Pandur variants, contract terms and vehicle features, the impact of logistical support and training, and the role of industrial offsets account for the increased per-vehicle cost.

¶10. (U) Concerning the comments of the Austrians, Bartak issued a personal statement labeling the affair "an intentional political game of discreditation...in the pre-election season" and repeated his message at a February 22 press conference. Meanwhile, Mirek Topolanek and his former Defense Minister Vlasta Parkanova (who is now with TOP09) have also been trading accusations in the media. Responding to Topolanek's statement that, "Parkanova bears full responsibility. I can only speculate as to why she wanted to allow an apparently corrupt project to remain valid," Parkanova insisted, "The Prime Minister himself

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supported the project from start to finish. There was a great rush to conclude a contract...(Topolanek) had a great interest in having the project shifted to Deputy Minister Bartak."

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Talk of Corruption in Defense Procurement Extends Back  
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¶11. (S) In mid-2004, a Steyr official told us (reftel E) about "shadowy forces" already at work in the tender, but pledged his company would adhere to ethical standards while lobbying Czech officials. One year later (reftel D) it appeared that PwC was preparing a transparent and open process. During this period, a member of the Czech Parliament familiar with military acquisition also indicated to us that a significant measure of transparency was being achieved in the tender process.

¶12. (U) Late in 2006 however, in connection with competitor Patria's legal challenge of the contract award to Steyr, the Anti-Corruption and Financial Crimes Unit (AFCU) of the Czech National Police began an investigation of the APC tender. The investigation was transferred to the Special Department of the Czech Military Police at the end of 2006 when it was

discovered that they too were looking into the tender. An unidentified Military Police source is quoted in MFD saying that the tender was found to have been conducted "in accordance with the rules". (The AFCU announced on February 19 that it is reopening its investigation.)

¶13. (C/NF) During renegotiation of the Pandur contract in early 2008, we were told by a Steyr representative (reftel C) that Minister Bartak had engineered an opportunity for former Topolanek protege and lobbyist Marek Dalik to solicit a substantial bribe from Steyr in exchange for getting the contract back on track, an allegation which we could not independently confirm.

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Comments  
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¶14. (C) As a military analyst noted in May of 2004 (Reftel E), "While the MoD is attempting to forestall any allegations of corruption in this (APC) tender, hiring (PwC) will not fix the acquisition system itself, which will continue to suffer from a lack of transparency." Six years later the same concerns exist regarding Czech procurement procedures. While several political parties have seized on the need to "get tough" on corruption, and there is proposed anti-corruption legislation making its way through Parliament now (reftel B), the Czech public remains skeptical that this is anything more than campaign rhetoric in the lead-up to May elections. Recent public polling indicates that two-thirds of Czechs are dissatisfied with the current political situation and just 20 percent of the public considers parliamentarians in the lower house "trustworthy." Considering that so many parties and politicians appear to be involved in this case, one likely result is that it will strongly reinforce the public's perception that all Czech politicians are tarred with the same brush.

¶15. (SBU) Embassy Prague regularly advances the importance of transparency with Czech officials, as we are currently doing in negotiating the Research, Development, Testing and Evaluation Agreement and the Reciprocal Defense Procurement MOU (reftel A) with the MoD. As well, post is collaborating with Ministry of Interior officials on training next month for law enforcement officials, judges, and prosecutors regarding combating corruption. Clearly, there is much room for more to be done.

¶16. (SBU) While this particular case appears to demonstrate that Czech government tenders remain flawed and nearly impossible to monitor, there are two positive elements worth noting. Czech media are vigorous and willing to take on officials, regardless of party or position. Second, Prime Minister Fischer, who leads the current interim government and was not aligned with any party before he was elevated to PM from the Czech statistical office, appears genuinely focused on getting to the heart of any wrongdoing. Nonetheless, with something at stake for almost all of the political parties and an election in May, it remains to be seen whether the major parties will, as CSSD leader Paroubek has suggested, "let the chips fall where they may."

Thompson-Jones